

**DEPARTMENT OF STATE REVENUE  
LETTER OF FINDINGS NUMBER: 04-0147  
Adjusted Gross Income Tax and Penalty  
For the Years 2000-2001**

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**ISSUE**

**I. Adjusted Gross Income Tax-Addback of state and local income taxes**

**Authority:** Ind. Code § 6-3-1-3.5; O.R.C. Ann. §§ 5733.05-.06.

Taxpayer maintains that the Department of Revenue erred when it added back a portion of its Ohio Franchise Tax

**II. Tax Administration-Penalty**

**Authority:** Ind. Code § 6-3-4-4.1; Ind. Code § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of the ten percent (10%) penalty for negligence.

**STATEMENT OF FACTS**

Taxpayer is a company doing business in multiple states, including Indiana. On its corporate income tax return, taxpayer reported its federal taxable income, adding back Indiana income taxes and a portion of its Ohio Franchise Tax. However, taxpayer did not add back a portion of Ohio Franchise Tax that it considered to be a tax on its net value as a company, rather than its income. The Department added back the excluded portion of the tax to arrive at its adjusted gross income, and assessed a negligence penalty. Taxpayer has protested this addback, and a hearing was held.

**I. Adjusted Gross Income Tax-Addback of state and local income taxes**

**DISCUSSION**

Under Indiana's corporate income tax, Ind. Code § 6-3-1-3.5(b)(3) provides that, for corporations, amounts taken as a deduction for state taxes "based on or measured by income" are to be added to federal taxable income to arrive at adjusted gross income.

Under Ohio's Franchise Tax, effectively two taxes are imposed. The first tax is a tax on the net worth of companies. For most corporations (including taxpayer in this case), the book value of the company, with minor modifications, is computed. Then, the taxpayer computes an apportionment factor based on its property, sales, and payroll in Ohio relative to its values nationally, multiplies the apportionment factor by the book value, and a tax of 0.4% is imposed on that value, up to a limit of \$150,000. O.R.C. Ann. §§ 5733.05(C), 5733.06(C). The second tax is a tax imposed on the net income of the company, similar in most respects to Indiana's corporate adjusted gross income tax. O.R.C. Ann. § 5733.05(B), 5733.06(A)-(B). Once these two amounts are computed, the taxpayer pays the higher of the two taxes. Taxpayer in this case paid the amount represented by the net income tax. O.R.C. Ann. § 5733.06.

Taxpayer argues that, since the franchise tax is based on the privilege of doing business in Ohio regardless of net income, the portion of the franchise tax that is represented by the net worth portion should not be treated as a tax "based on or measured by income" for purposes of determining its adjusted gross income for Indiana purposes. Taxpayer agrees that the amount above the amount computed solely on its net worth is properly added back for Indiana purposes.

Two questions come out of this protest: one, is the franchise tax based on or measured by income; two, if it is not, what portion of the tax is a tax based on or measured by income?

Here, what has transpired is that taxpayer's Ohio state tax, by virtue of the "higher of" calculation dictated by Ohio law resulting in the tax on the income portion being due to Ohio, is a tax "based on or measured by income" within the meaning of Ind. Code § 6-3-1-3.5(b)(3). Accordingly, the full amount should have been added back.

### **FINDING**

Taxpayer's protest is denied.

## **II. Tax Administration-Penalty.**

Taxpayer also protests the imposition of the penalty for negligence for the years in question. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10-2.1. The Indiana Administrative Code further provides:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on

a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

45 IAC 15-11-2.

With respect to the penalty, taxpayer has presented a case that it acted with reasonable cause, and thus the penalty should be waived.

### **FINDING**

Taxpayer's protest is sustained.

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